

Vermont's Education Funding System

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OVERVIEW OF GENERAL EDUCATION FUNDING SYSTEM

As a result of the Vermont Supreme Court Brigham decision of 1997, Vermont now provides total state funding to its school districts. Prior to this court decision Vermont used a foundation formula to provide state aid to augment local school district property taxes.

In its simplest terms, a state funding system replaces a state aided local tax system. The state now pays each district the amount needed to fund the district's locally adopted budget through an education fund. This amount equals the total voter approved expenditure budget less any amounts for expenditures that have specific funding. Examples of specifically funded amounts include federal programs and state categorical grant programs. The state funded portion is called the district's "education spending."

The state then divides each district's education spending by the district's equalized pupil count. The equalized pupil count uses a weighting system for various student types. The resulting spending per pupil amount for a district is used to determine the district's homestead-state-education- property tax rate. The rates start at a low level and are associated with a base per pupil spending amount, then increase proportionally at higher per pupil spending amounts. A district with a per pupil spending amount 20% above the base will have a tax rate 20% above the base tax rate.

The resulting school tax rates for residents will apply to one of two tax bases. The homestead education property tax rate is applied as a percentage to a resident's homestead market value. The second rate is applied to the household income of those living in the homestead. The second rate is for households with incomes of \$90,000 or less as an alternative to the property tax should that method yield a lower tax bill.

The system is intended to apply pressure to voters if they approve spending amounts that result in high per pupil spending. If the voters in a district approve a budget that produces higher per pupil spending, the voters will have higher tax rates.

Regardless of the level of per pupil spending approved by the voters, property tax payers with homesteads of the same market value living in districts that have the same per pupil spending amount, pay the same tax within the tolerances of the system. That is, if two districts have the same per pupil spending amount, the tax rates will be the same and tax payers with the same market value homestead or household income will have equal tax bills. This taxing system provides the equity to Vermont's school funding system.

One complexity is a local adjustment to the homestead property tax rate. This adjustment is necessary because it is too difficult for towns to keep properties listed at the current market value. Applying state rates to property listings that vary significantly from market value would produce unequal taxing. Each year the tax department establishes a "common level of appraisal" or CLA for each town. Homestead tax rates are then adjusted by the town's CLA so that tax amounts will be equalized.

The following description of Vermont's education funding system is intended to describe the basic process of Vermont's education funding system. There are many technical details that go beyond the scope of this presentation.

Basic Funding

Under Act 68 of 2003, the state's Education Fund provides money to school districts in two major categories: **categorical grants** and the **education spending** portion of school district budgets. These amounts will total more than \$1 billion. Union districts are included in FY 2009 for the first time as a result of Act 130 of 2004. They were funded by assessments to member town school districts before then.

What Are State Categorical Grants?

State categorical grants are separate grants distributed for specific purposes from the education fund in certain spending categories. Examples of Vermont's categorical grants for FY09 are listed below:

Special Education Aid (about 60% of eligible special education)	\$142,500,000
Transportation Aid (about 44% of transportation expenditures)	\$15,000,000
Small School Grants	\$6,600,000
Aid for State-placed Students	\$16,400,000
Technical Education Aid	\$12,400,000
Essential Early Education Aid	\$5,500,000
Total	\$198,400,000

What Is "Education Spending"?

Act 68 now pays for all of a district's education spending. How is this amount determined? Education spending is that part of an expenditure budget without a specific funding source. It includes the portion of special education costs not covered by federal aid and the state categorical grant, transportation costs not covered by the state categorical aid, as well as any tuition owed by the district, general payroll and operation costs that do not have specific funding sources. See 16 VSA § 4001(6) for the legal definition. Operationally it is determined as shown below.

Budget adopted by school district (town, city, union, incorporated)
 + Deficit from prior year (if any)
 Total District Budgeted Expenditures

Total District Budgeted Expenditures (town, city, union, incorporated)
 – State categorical grants, federal revenues, tuition revenues, interest income, etc.
Education Spending

In FY 2009, education spending statewide is about \$1.11 billion, or 78% of total PK – 12 spending (includes spending from other sources such as federal and categorical grants).

How Is Education Fund Money Raised?

The amount needed in the Education Fund to pay for categorical grants and education spending is about **\$1.31 billion** in FY 2009. January 2009 revenue estimates for the Education Fund sources in FY 2009 are given below.

• Nonresidential Education Property Tax	\$535 million
• General Fund Transfer	\$291 million
• One-third Sales & Use Tax	\$106 million
• One-third Purchase & Use Tax	\$24 million
• State Lottery	\$22 million
• Medicaid Reimbursement	\$5 million
• Vermont Yankee	\$2 million
Total raised	\$985 million

Where's the Missing Money? The Variable Homestead Property Tax Rate

The amount raised above is shy of the \$1.31 billion needed to pay school districts. One significant revenue source has been left out. All of the above revenue sources are raised through a fixed tax rate throughout the state applied to the indicated tax base. The source left off the above list is the homestead property tax. This tax provides the balance of the funding, about \$342 million. Its rate varies proportionally with a district's education spending per pupil. The pupil count used in this determination is called the "equalized pupil" count and uses weighting for different types of pupils. The details of the equalized pupil count are discussed in a separate paper.

What is a Homestead?

32 VSA § 5401(7) provides the legal definition of a homestead. The basic components are given below.

- "[T]he principal dwelling owned and occupied by a resident individual..."
- Includes, "parcel of land surrounding the dwelling...."
- "[D]etermined without regard to any road which intersects the land."

How Are Homestead Tax Rates Determined?

A district's education spending is first divided by its equalized pupil count to determine the district's average education spending per equalized pupil. This amount is compared to the state's base education spending amount per pupil to determine the percent variance. The base amount is set each year by the Legislature and is \$8,210 in FY 2009. The variance percentage is applied to the state's base homestead tax rate to get the district's tax rate.

For example, if in FY 2009, a district's education spending per pupil is \$9,031, its spending per pupil would be 10 percent greater than the \$8210 base amount. The base homestead tax rate which is \$0.87 in FY 2009 is then increased by the same percentage or 10 percent in this case or 0.95. All districts that have the same education spending per equalized pupil will have the same

homestead tax rate. Homestead property tax rates can not be lower than the base rate even if the district spends less than the base amount.

Most homestead tax payers can get all or a large portion of their homestead property taxes adjusted so that the taxes are more reflective of income rather than property value.

What Are Homestead Tax Adjustments? (Formerly Prebates or Income sensitivity)

The homestead tax for eligible payers will be reduced by an amount equal to the following:

- A. If household income is \$90,000 or more, the property tax on the first \$200,000 of housesite market value (house and up to two surrounding acres) minus the applicable percentage of the household income.
- B. If household income is less than \$90,000 the homestead tax on the housesite minus the applicable percentage of the household income. An additional reduction of \$10 per acre for up to five acres beyond the housesite's two acres will also be made.

The applicable percentage of household income starts at 1.80% in FY 2009 and increases proportionally as the amount education spending per pupil exceeds the base amount the same way the homestead property tax rate increases. Beginning with the fall of 2007, adjustments determined based on prior year income and homestead tax are made on an individual's property tax bill. This change ended the prebate program and checks are no longer sent to taxpayers, rather tax bills are reduced directly by the adjustment amount.

Homestead Tax Rate Examples

The table below shows examples of tax rates using an \$8,210 education spending per equalized pupil base amount. For FY 2009, the base homestead rates are 1.80 % of household income and \$0.87 per \$100 of homestead market value.

Education Spending per Equalized Pupil	Percent of Household Income	Homestead Property Tax Rate
(Base) \$8,210	1.80%	0.87
\$8,301	1.98%	0.96
\$9,852	2.16%	1.04
\$10,063	2.34%	1.13
\$11,494	2.52%	1.22
\$12,315	2.70%	1.31

What is Nonresidential Property and How is this Tax Raised?

Nonresidential property is any property that is not a homestead with certain exceptions. See 32 VSA 5401(10) for statutory definition.

The property tax rate for all nonresidential property in the state is set in 32 VSA § 5402(a)(1). This rate is \$1.59 for each \$100 of fair market value.

Annual Adjustments to Statutory Tax Rates

Each December 1 the Tax Commissioner recommends adjustments to the \$1.59 nonresidential tax rate and the \$1.10 homestead tax rate based on the following:

- Projection of the amount in the education fund reserve, and
- The nonresidential rate must produce at least 34 percent of education fund spending.

For FY 2009 the nonresidential tax rate is \$1.36 and the base homestead tax rate is \$0.87.

Does the Law Limit Education Spending?

The law does not limit how much a district can spend; that amount is determined by the district board of directors and the district voters. However, districts with education spending per equalized pupil exceeding a prescribed amount, the threshold, will be subject to an additional tax rate. This is one of the provisions made to help constrain education spending. The additional rate is determined by adding to the district's education spending per pupil the amount that education spending per pupil exceeds the limit.

FY 09 High Spending Threshold = 25% above state average education spending per pupil of the prior year or \$13,287.

The spending threshold for a school district is determined by first deducting any approved capital construction debt service spending.

Excess Spending Example

In FY 2009 the limit is \$13,287 per equalized pupil. The illustration below shows the tax rate that would result both without and with the limit for a district with education spending per pupil of \$13,587 using the FY 2009 base amount of \$8,210 and base rate of \$0.87.

	Threshold	Education Spending per Equalized Pupil	Added Amount	Amount Per Pupil Used for Tax Rate	Equalized Tax Rate
Example if there were no excess spending provision	None	\$13,587	0	\$13,587	\$1.44
Example With excess spending	\$13,287	\$13,587	\$300	\$13,887	\$1.47

What Is CLA and How Is It Used?

The CLA or **common level of appraisal** for each town is determined each year by the Tax Department's division of property valuation and review (PV & R). PV & R compares property values listed by a town in various categories to actual sales data for each particular type of property. Using actual sales data and statistical analysis PV&R determines how close a town's grand list is compared to what it would be if all properties were listed at 100% of fair market value. It expresses this CLA as a percentage.

To ensure that state education property taxes are all assessed on the same basis, the tax commissioner is directed by law to set the tax rates in each municipality (see 32 VSA § 5402) by dividing tax rates for nonresidents and homesteads by the municipality's CLA. For example, if the education spending per pupil in a district for FY 2009 is \$9,852, the homestead tax rate from the table above would be \$1.04 (1.04% of the market value). If the CLA in that town was determined to be 85%, it would indicate that the town's grand list was 85% of market value instead of 100%. The tax commissioner would divide \$1.04 by 85% and get a tax rate for that town of \$1.22 to adjust for the variance. The \$1.22 rate would appear on the town's tax bills.

All towns that have the same education spending per pupil with the same CLA would have the same tax rate appearing on the tax bills. More likely, even if per pupil spending amounts were the same in two towns, the CLA for each would not be the same and the tax rates on the tax bills would be different.

Act 130, Union School Funding

Until FY 2007 union school districts were not recognized as districts in Chapter 133 of Title 16, the education funding chapter. This meant that until then union school districts did not receive education spending funding, did not have a cost per equalized pupil, and did not have a tax rate. To receive funding, these districts assessed costs to member town districts. The homestead tax

rate for town districts that were members of a union district was a combination of the town district budget and the union district assessment. Union school budgets were and are determined by a district vote either using Australian ballot or floor vote at the union district annual budget meeting.

That system has led to some confusion because two or even three school boards were responsible for one cost per equalized pupil and it was next to impossible to break out the components. Put another way, it was hard to tell who was doing what to whom. Also, the law currently permitted union schools to assess costs to member town districts using any number of apportionment methods while funding was provided on an equalized pupil basis. This resulted in some members of the union being overcharged while others were undercharged.

Under Act 130, union districts are recognized in the funding law and beginning in FY09 will determine an education spending per equalized pupil amount and a corresponding homestead tax rate. These districts will no longer assess costs to member districts but will receive money from the state's Education Fund as do the town and city school districts.

To understand how Act 130 works it is necessary to understand the distinction between governing entities. Towns or cities raise the homestead property tax on behalf of the state. These are taxing entities. School districts, town, city, or union districts are educating entities and do not raise taxes. The homestead tax rate levied by a town will be based on the average education spending per equalized pupil of all the pupils living in the taxing entity.

In a K-12 district such as Rochester, all of the students in the taxing entity (the town) are members of just one school district. In a town associated with a town district and a union district, some of the pupils living in the town (the taxing entity) are members of the town school district and some are members of the union school district. The tax rate for the taxing entity (the town) will be the average tax rate (weighted average) of both districts.

If 60% of the pupils living in the town of Shelburne are members of the Shelburne Town School District, and the tax rate determined for that school district is \$1.30, then 60% of that rate will be applied by the town of Shelburne or \$0.78. If 40% of the students are members of the union district and its tax rate is \$1.40, then 40% of \$1.40 or \$0.56 will be applied by the town of Shelburne. The total tax rate for the town of Shelburne will be \$0.78 + \$0.56 or \$1.34.

60% x \$1.40 (elementary district rate)	=	\$0.78
40% x \$1.50 (union district rate)	=	\$0.56
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Town of Shelburne homestead equalized tax rate	=	\$1.34

The equalized rate of \$1.34 for the Town of Shelburne above would then be adjusted (divided) by Shelburne's CLA to get the rate appearing on the tax bill.